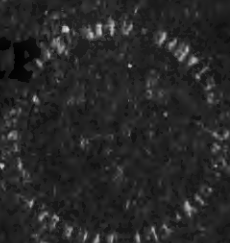


Queen's University

Course in Banking

LESSONS III-V

Corporation Finance



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LESSON III.—Continued.

Uses of preferred stock. Although preferred stock was originally the offspring of receiverships it is now widely used by industrial concerns. The reasons for its use are as follows:

(1) Preferred stock furnishes a convenient means of separating a company's stock into different voting classes. Some times the preferred stock carries with it no vote at all; again it may elect only a limited number of directors. In either case the majority of the owners of the common stock may elect a majority of the board of directors. It follows that a much smaller interest may control the business than if all the stock issued voted alike.

(2) Preferred stock is very useful in forming industrial combinations. It represents the present value of the whole concern, while the common stock represents potential earnings. The subsidiary company stockholders will be willing to accept preferred stock for their former holdings, whether common or preferred, whereas no one can foresee whether common dividends will be paid or not.

(3) Preferred stock issues are useful in changing partnerships into the corporate form. In this case the preferred stock may have preference over the common with respect to its voting power alone.

(4) Preferred stock may attract conservative investors in a new business—or, indeed, in any concern—whereas they might not care to buy the more speculative common stock of a corporation. The preferred stock, as will be recalled, stands in point of security between the lowest grade of bonds and the common stock.

Voting power of stock. Originally the universal custom in all corporations was to give one share of stock one vote. The custom is still general but by no means universal. The following important modifications should be considered.

In order to protect the minority holders of stock it is a very common custom, especially in England, to restrict the number of votes allowed to any one stockholder. Thus a man with ten shares or less may have one vote for each share; for each additional share up to twenty he may have half a vote per share; and so on as his holdings increase. The arrangement, at first glance, seems an admirable one. The difficulty, however, is found in the ease with which the owner of a large block of stock can divide it up among his family and friends, and thus secure complete control of the corporation.

The system of "cumulative" voting followed in the United States is more effective. In this case each share has as many votes as there are directors to be elected. If these votes are

concentrated on one or two men the minority are almost certain to have representatives to look after their interests on the board. If the majority holders scatter their votes in an attempt to elect the whole board it is evident that the minority might easily control the board, provided they are organized and concentrate their efforts on the election of certain men. It may be said in passing that the constitution of Pennsylvania contains a clause requiring that all corporations organized under the laws of that state shall conduct their elections by the cumulative voting method. This method of voting will give best results for most corporations.

Voting trusts. Voting trusts are formed for the purpose of protecting the rights of minority shareholders and of creditors. Under it a majority of the voting stock of a corporation is placed in the hands of trustees who are authorized to vote it under whatever limitations are prescribed. The trustees as a rule issue "voting trust certificates" which certify that the stock is held by them in trust. These certificates may be sold and transferred in the same manner as certificates of stock. The stock is voted for certain officials or for certain measures; and the minority stockholders and the creditors may feel that their rights will be amply protected. Of course, a voting trust agreement that seriously restricts the freedom of the majority stockholders of a corporation is not palatable to them; and the agreement is usually put through only under strong pressure, as when, for example, new capital is required or the corporation is laboring under financial difficulties.

The corporate form of industrial and financial organization has placed immense financial power in the hands of a comparatively few men; for, on the whole, at least in Canada and the United States, the small stockholder in the large concern leaves the control and management of the organization to the directors elected by the large shareholders. Although, in the main, the modern corporation differs from the early business types more in degree than in kind, still the power of the new combination has become so enormous as to require an entirely new adjustment of industrial and political relations. We are thus confronted with the necessity of harnessing great economic forces by such checks and balances as will, while preserving to society their undeniable advantage, at the same time protect all men in the enjoyment of equal industrial and financial rights. From the point of view of the small stockholder, "cumulative" voting is a step in the right direction.

II. Types of Business Corporations.

Up to the present we have described but two types of corporations—the stock and non-stock. As has been said the non-stock corporation is used largely for educational, religious and charitable organizations. The absence of stock leaves no method for obtaining capital, except by borrowing; and it would be difficult under this organization to distribute profits. Hence the business world has turned to the stock corporation for its system of industrial organization.

We may further classify stock companies as private and quasi-public. The latter consist of companies that perform a service for the whole community for the sake of profits to the owners of the company. Examples are found in steam and electric railroads, gas, telephone and telegraph companies, and the like. Such corporations are granted peculiar rights; such, for example, as the right of eminent domain—the right to expropriate private property for their own purposes. On the other hand they are subject to special legislative control because of their essentially public nature. Private corporations, on the other hand, consist of manufacturing and trading concerns which do not have special franchises and are carried on entirely for the sake of profits to their owners.

Private corporations may be further classed as "close" and "open." The former are made up of people who are few in number and who have no intention of parting with their holdings. Partnerships and family concerns are often turned into this type of corporation; and in the United States large estates are sometimes so constituted by executors, in order to settle complicated business affairs with greater ease. Most business concerns are "open" corporations, consisting of a considerable body of shareholders who are willing to sell their stock on favorable terms.

The parent company. The parent company is quite often confused with the holding company, although they are distinct and different types of business organization. The parent company is one that does not wish, for some reason, to carry on business under its own name over the whole country and therefore organizes and controls one or more subordinate companies. Among the reasons for this form of organization are the following: The parent company may wish to operate in several different countries, in which case it will be necessary to form new corporations in the several countries in which business is carried on. Several English companies, for example, have subordinate organizations in the United States, and many American corporations operate in the United Kingdom. Again, the desire to avoid heavy local taxa-

tion favors the organization. As the parent company is not known, at least officially, to the local authorities, the burden of taxation is greatly reduced. Then again it is desirable to have local men in charge of the various plants of the corporation, and to give these men a stock interest, not in the parent company, but in the branch business. In a sense the parent company is a holding company since it controls the stock of the subsidiary concerns, and since, moreover, the branch plants are operated in its interests. But it is not a typical holding company in the real meaning of that term.

The holding company. A holding company comes into being through securing control of the stock of already established concerns. The real reason for its existence is not the securing of returns upon the stock that it holds, but the control of various hitherto independent competitive organizations. The control may amount to the ownership of a bare majority of the voting stock of the subsidiary concern; but as a rule an attempt is made to control as much stock as possible, so that the holding company may be in a position to completely dominate the situation. It may be necessary, in the interests of economy, to concentrate production in the best plants and permit the poorer plants to gradually close their doors. Now, it is obvious that if there is a strong majority interest in these poorly equipped plants it will be difficult for legal and other reasons to put this policy into effect. And, on the other hand, it is always advisable for a holding company to own as much stock as possible in those plants whose business it intends to expand.

A holding company, in theory, may be only the holder of the majority interest in the stocks of subsidiary concerns, but in practice it is the virtual owner of the property, whatever form it may assume, of the subsidiary organizations. This dual function of the holding company is disclosed in the balance sheet of the concern. In the report of a holding company there are almost always found two balance sheets and two income statements. The first balance sheet shows the securities in the treasury of the holding company, and the first income statement reports merely the dividends and interest received on these securities. The second balance sheet, usually called the "consolidated" or "general," shows as assets the physical property of the subsidiary companies, while the second income statement shows their combined profits. A knowledge of these facts will very often help stockholders to appraise properly the status of their own company.

The holding company and the "trust." The United States is the country *par excellence* of the "trust." It is through the

holding company that those vast industrial and railroad combinations are now formed which are known as "trusts." In early days the "pool" and the "trust" were the methods adopted to effect industrial combinations. The pool was nothing more or less than a "gentlemen's agreement" among those concerned with respect to the division of the output and the fixing of prices. Because it was an agreement depending upon the word of honour of those concerned it broke down. Besides it violated the principles of the English common law—that is, law built up on tradition, custom and legal decisions and practice—which forbade combinations that unduly restrained trade. The trust was constituted on a different legal basis. The holders of the voting securities of competing companies turned over a majority interest in each company to one man or to a small group of men, and received in return what were known as "trust certificates." The trustees thus could control the policies of hitherto competitive organizations. The trust also was proved to be illegal under the common law. The reasons therefor are stated clearly in the following judgment given in 1890 against the North River Sugar Refining Company, a New York corporation. The court held that this company was a combination "the tendency of which is to prevent competition in its broad and general sense and to control, and thus at will, enhance prices to the detriment of the public. The corporation, entering the trust, had exceeded the powers of its charter. The defendant had disabled itself from exercising its functions and employing its franchise as it was intended it should by the act under which it was incorporated, and had, by the action which was taken, placed itself in complete subordination to another and different organization to be used for an unlawful purpose, detrimental and injurious to the public. This was a subversion of the object for which the company was created, and it authorized the Attorney-General to maintain and prosecute this action to vacate and annul its charter." The Standard Oil Company was also declared illegal on similar grounds by the Supreme Court of Ohio in 1892. Thus, both the pool and the trust have given way in the United States to the holding company, the modern form of combination.

The "trust," in the form described, established an absolute control over the separate properties, all executive officers of the various companies being elected by the trustees, and dividends being distributed to all holders of certificates whether the properties represented were idle or not. A trust was not an incorporated company, and thereby not being required to make reports, could maintain entire secrecy as to its operations. Its power resided in

its ability to unify the action of all its members. In the end, however, the peculiar nature of the trust led to its abandonment; being only an association in the eyes of the law, and not a legal person, it could be declared illegal. In other words, it was merely a "pool" pushed a little farther. Similar associations in Canada, notably an association of master plumbers in Toronto, formed some years ago, have been declared illegal by the Canadian courts.

The holding company was first made possible by an amendment to the corporation law of the State of New Jersey, which read as follows:

"Any corporation may purchase, hold, sell, assign, transfer, mortgage, pledge, or otherwise dispose of the shares of the capital stock, or of any bonds, securities, or evidence of indebtedness created by any other corporations of this or any other state, and while owner of said stock may exercise all the rights, powers, and privilege of ownership, including the right to vote thereon."

This legislation produced profound changes in the organization of industry in the United States; for it was now possible to effect combinations that could not be touched by the courts of those states that had passed anti-trust laws. The federal courts of the United States alone could deal with corporations that carried on an inter-state business, and they were subject, with respect to this phase of their business at least, to laws of the United States alone. The United States has passed a notable act—the Sherman Anti-Trust Act of 1890—forbidding combinations in restraint of trade between the several states and with foreign nations. Under this act the Standard Oil Corporation—a holding company of New Jersey—was declared to be a combination in restraint of trade, and was dissolved. Nevertheless, the holding company is the typical form of industrial combination in the United States to-day, and it yet remains to determine to what extent it is a legal form of business enterprise. While it is foreign to our purpose at this point to investigate the question of industrial combinations either in Canada or the United States, the following observations of a qualified American writer will prove instructive as showing the general position in which the holding company stands to-day in the United States:

Restraint of Trade.

"Though we know fairly well what acts are forbidden by the Sherman Anti-trust Law, we do not know to what extent that statute permits combination or co-operation. Upon this

vitaly significant question we shall probably be enlightened when the Supreme Court renders its judgment upon the appeals in the Steamship Pool case, decided last month by the Federal District Court in New York, and in the Harvester case, decided in August by the Federal District Court in Minnesota. These two cases present the same fundamental question, but the two decisions answer the question quite differently.

What the Supreme Court will tell us is the test of the validity of a combination. Does that validity depend upon the resulting injury or benefit to the public, as shown by the facts in the particular case, or is it dependent upon the observance of certain positive rules against the restriction of competition? A clear answer to this question will be the only way of settling the widespread difference of opinion as to whether the mere power to crush competition renders a combination unlawful, without regard to whether the combination has actually exerted that power.

In the Steamship Pool case it appeared that nearly all of the transatlantic steamship lines had entered into an agreement, known as the North Atlantic Conference, to apportion among themselves the traffic in steerage passengers and to fix the fares to be charged. Each line was free to secure such share of the traffic as it could, but a line obtaining more than its agreed quota was bound to compensate other lines which failed to get their share. The agreement was subject to revision from time to time, and this furnished an incentive for competition, since a line which did not prove its capacity to hold its share of the business was liable to have this share reduced at the next apportionment.

Here was a combination to prevent free competition and to regulate the charges for transportation on the ocean, with sufficient power besides to crush outside competition. While the Court restrained the abuse of power by prohibiting the operation of "fighting ships," it unanimously refused to dissolve the combination itself, on the broad ground that the evidence proved no injury to the public, but rather a benefit. The Court found that there was no evidence that the rates fixed were unreasonably high. It examined the peculiar circumstances affecting carriage by sea, which makes the problem of conducting it altogether different from the problem of conducting railroad transportation. The history of ocean transportation convinced the Court that without some method of regulating competition there would be a succession of rate wars which would put the weaker lines out of business, prevent the improvement of service, and probably result in the establishment of an effective monopoly. So the Court concluded that instead of restraining trade, the conference agree-

ment really fostered and protected trade by giving to it a stability which insured a more satisfactory public service.

In the Harvester case, on the other hand, the Court decided that there was a violation of the Anti-trust Act, because the International Harvester Company, by combining five competing companies, had acquired control of about eighty-five per cent. of the trade in necessary farm implements. This fact was the sole ground for the decision. The majority of the Court—for there is a vigorous dissenting opinion by Judge Sanborn—gave no consideration to the effect of the combination upon the trade and the public. The evidence, as is conceded by the judges, showed that there was no over-capitalization; that the Government's charges of the use of unfair methods to crush competitors were unfounded; that while harvesting machines had improved in quality, prices had advanced but little, and such advance was much smaller than in the case of other agricultural machinery in regard to which there was no claim of restraint of trade. The evidence also showed that though the foreign business of the combined companies had increased immensely, their proportionate share of the domestic trade had considerably decreased, and that outside competition had grown and flourished.

The opposition between the two decisions is thus manifest. Which view of the law will be taken by the Supreme Court?

In its later opinions, beginning with the Standard Oil case, the Supreme Court has tended very distinctly towards the adoption of injury to the public as the test of violation of the Sherman Act. It has repeatedly declared that the words "restraint of trade," at common law and in the law of this country at the time of the adoption of the Anti-trust Act, embraced those acts only which operated to the prejudice of the public interest, and that these words in the statute have the same meaning as at common law. The common law as to restraint of trade was declared last winter by the House of Lords, the highest court of Great Britain, in *Northwestern Salt Co. vs. Electrolytic Alkali Co.*, a case which cannot fail to have great weight with our Supreme Court. The question before the English Court was whether a combination of salt manufacturers for the purpose of limiting the production of salt and of maintaining the price was invalid at common law because in restraint of trade. The House of Lords held that the question could not be determined upon a mere inspection of the terms of the agreement by the application of a general rule, but that the decision must depend upon the injury or benefit to the public resulting from the combination, as disclosed by the evidence. Lord Chancellor Haldane said: "Unquestionably the combination in question was one the purpose of which was to regulate supply and keep up prices. But an ill-regulated supply and

unremunerative prices may, in point of fact, be disadvantageous to the public. Such a state of things may, if it is not controlled, drive manufacturers out of business or lower wages, and so cause unemployment or labor disturbance. It must always be a question of circumstances whether a combination of manufacturers in a particular trade is an evil from a public point of view."

If the test to be applied in the pending cases is injury to the public, one would expect that the Supreme Court, unless it finds that the evidence does not sustain the conclusions of the lower courts, will affirm the decision in the Steamship Pool case, and will reverse the decision in the Harvester case. One result would be to make clear to the country that in cases under the Anti-trust Acts, courts do not actually decide questions of law by the application of definite legal rules, but decide economic questions depending for their wise solution upon a thorough understanding of the facts and the needs of business in relation to the welfare of the people as a whole.

The problem would then have been faced squarely. It would be understood that the legal conditions under which business shall grow cannot be derived from legal precedent, but must be determined with a great deal of flexibility in accordance with a social policy.

Probably the country would applaud the common sense of such an interpretation of the statute. But there might well be doubt as to the wisdom of leaving the determination of such questions to judges who are busy with other matters, have no facilities for investigation, and are not specially qualified for the task either by training or experience. Perhaps, if the new Federal Trade Commission wins public confidence, it may in time be thought best to confide to it in the first instance the administration of the Anti-trust Act."

Complexity of holding companies. It is well to bear in mind that combinations may result, in the long run, in gains for all classes in the community, through economies of management and production. And yet, on the other hand, it is possible through the holding company to concentrate a few hands control of a group of vast industrial organizations. For holding companies may be formed not only to acquire stock in operating companies but also to obtain control of other holding companies. Then again the stock of the second holding company may be purchased by a third still greater holding company. The result is that an extensive organization may be built up in which so many companies may be involved that it becomes a difficult matter to trace their relations to one another. An example of this is found in the Interborough-Metropolitan Company of New York City. It controls all the street

car, elevated and subway railway lines in the principal boroughs of New York City. It was formed by an exchange of its securities for the securities of two formerly competing companies, the Metropolitan Securities Company and the Interborough Rapid Transit Company. The relations of these two companies to each other, to their direct subsidiaries, and to the subsidiaries of their subsidiaries, have involved them in an almost inextricable legal tangle. Many other examples might be given. The most notable example of the holding company in Canada is that of the Dominion Steel and Coal Corporation, Limited, which controls both the Dominion Iron and Steel Company and the Dominion Coal Company. It is not necessary, however, to describe in detail the holding company as it exists in Canada, as it has been based upon the United States model.

Questions for Review.

1. Should stock certificates be negotiable? Give reasons for your answer.
2. In your opinion would it serve as well to state the number of shares in a company's capitalization as to give the amount of the par value of the stock?
3. What are the differences, precisely, between common and preferred stock?
4. State the four chief reasons for the issue of preferred stock.
5. What is the voting power of (a) common, (b) preferred stock?
6. What is meant by a "voting trust"? For what reasons is it created?
7. State the chief types of business corporations.
8. Explain the causes that give rise to the formation of "parent" companies.
9. What is meant by "close" and "open" corporations?
10. Explain in detail how a holding company is created.
11. What were the reasons for forming "pools"? Why did this form of business combination break down?
12. What is meant by the "trust" in the original meaning of that term? Why was it declared illegal in the United States?
13. What is a holding company? Give examples of holding companies in Canada.
14. What types of holding companies have been declared illegal in the United States? In England?
15. What are the advantages of the holding company?

Questions for Written Answer.

16. A holding company may be formed to control a holding company, and the process may be continued. Do you see any dangers in the movement?

17. Distinguish between a "voting trust" and an industrial trust. What is the purpose of the former?

18. Explain carefully the powers and privileges of preferred stocks. What are the several types?

19. Bring up any difficulties.

LESSON IV.

Promoting the Enterprise.

Canadian opportunities. In the promoting of enterprises, as in almost every other phase of the corporation problem, Canada has followed American practices. Great enterprises were launched in the United States, however, many years before Canada had achieved much in industry. But in recent years, in almost every direction—in railroad construction, in manufacturing, in banking, in insurance and elsewhere—Canada has gone forward rapidly. The population of the country increased from 5,371,315 in 1901 to 7,206,648 in 1911, and stands to-day at about 7,500,000. These figures prove that Canada is now one of the fastest growing countries in the world. True, the war has put a temporary check upon European immigration; but the vast, unoccupied and fertile lands of the country will act as a powerful magnet in drawing thousands and millions of immigrants to our shores. Therefore when trade and industry again become normal endless opportunities will be presented to the promoter in organizing new enterprises of every variety. In a word, the work and place of the promoter in Canadian trade and industry will be more important than in the past, great as these have been. It will be necessary, therefore, to examine somewhat carefully the functions of the promoter in modern industrial life.

What the promoter does. The promoter's chief function is to discover new opportunities for making financial gains, and to organize companies to develop those opportunities. He may also aid in finding a market among speculators and investors for the stocks and bonds of the organization which he has helped to launch on its career.

Very frequently the promoter is without detailed knowledge of the technical side of the industry in which he is, for the time being, interested. In that event he calls to his aid experts who submit all the necessary data to enable the promoter to present to those whom he seeks to interest an intelligent account of his undertaking. Once having thoroughly investigated and understood the problem he must next attempt to get financial support.

Promoting the enterprise. When the conditions are favorable a good enterprise is most easily presented and financed among the friends and acquaintances of the promoter. If, however, he has had little or no business experience, or if he has been unsuccessful in other ventures, or if the proposed business

is new and untried, or on a big scale, he can hardly expect to get sufficient financial support in this way.

Very much, therefore, depends upon the type of business that is to be promoted. Sometimes a letter to those who may be interested will prove more successful than a personal visit; as, for example, in the case of a chemist's invention for preserving meat. It goes without saying that it would prove difficult to see a great packer, the head of a great enterprise, in person. As such men are experts in their line it is not necessary to write a lengthy letter. The facts should be presented clearly, carefully and briefly, and the results left to the good judgment of the manager of the business concerned.

In most cases, however, in any business that is to be conducted on a large scale, the promoter must meet capitalists in person, either in Montreal, New York, London or elsewhere. There is, as a rule, and under normal conditions, plenty of capital at these centres ready to be invested in businesses of the right sort; but it must not be forgotten that there are, also, many enterprises seeking this money. As a rule, the great banking houses should be avoided unless the proposed enterprise is to be carried out on a large scale. If the promoter, however, has once made up his mind that the leading financiers are the men he must reach he must equip himself with personal or business cards, considerable assurance, and a determination not to be discouraged by refusals. It is no uncommon thing in New York or London to pay a commission to certain intermediaries in an attempt to reach the heads of the financial houses whom the promoter seeks to interest in his proposition. Once the executive authority of a financial concern is reached, further progress will depend upon the ability of the promoter in presenting his case. Once, however, a reliable financial house has taken up the matter the problem of organizing the enterprise becomes very much simplified.

It goes without saying that financial houses must be appealed to along the lines in which they are engaged, whether railroad, industrial or other. In the field of invention certain houses make a specialty of selling patents. In any case the promoter must carefully select the banking or brokerage house to which he makes his appeal for financial aid. As a rule he should ignore advertisements in the financial press which offer to provide funds for new organizations. These advertisements are placed, for the most part, by a certain class of men who make money out of the unwary without providing any real help to those who consult them.

In certain quarters the promoter has been looked upon with suspicion of late years. Extravagant

promises have been made which have not been, and could not be fulfilled. Investors have suffered losses and as a result some suspicion has been cast upon the promoter and his work. It must not be forgotten, however, that the function of the promoter is an entirely legitimate one—the discovery of new enterprises and industrial possibilities, or economies that may be effected through combination and amalgamation. In this sense the promoter performs a real economic service to the community at large, whose value should not be overlooked.

"Assembling" the proposition. When the promoter has satisfied himself as to the success of his enterprise he proceeds to "assemble" it. He proceeds to get options on such property as will be needed, at as reasonable prices as possible, assuring the owners that he will be able to get the necessary capital to carry the undertaking through. Of course, options are not required in every case; but if the company is to be organized to carry on an established business, or to combine certain existing corporations, options must be secured by the promoter. As a rule, the promoter is able to make contracts with individuals or firms at closer prices, when he deals with them himself, than would be possible if these firms or persons were dealing with an established corporation. If prominent men are to be connected with the new organization it will be found very useful, too, for advertising purposes to have arrangements with them so that their names can be inserted in the prospectus. All this will increase the promoter's chances of successfully floating the company and of making larger profits for himself.

What has been said applies largely to the organization of a company to carry on a new undertaking. In recent years, both in Canada and the United States, the promoter's chief work has consisted in promoting mergers or combines—"trusts" in the later use of that word. We must, therefore, consider his work in this particular field.

The trust promoter. The trust promoter consolidates a number of hitherto competitive organizations, or different organizations, under a central organization. Large industries engaged in making cement have been consolidated into one; fifty or sixty canning factories have been unified in one organization; and so on throughout almost the entire field of Canadian industry. In the last few years more than seventy-five such combinations have been effected in Canada.

As in the cases already considered the promoter must first convince the manufacturers that his scheme will be a success,

that it has a sound industrial basis and assured financial support. He must further offer the owners sufficient inducement to sell.

Arguments for Combination.

To convince the owners of their disadvantages under competition is not hard. The promoter enumerates several plausible reasons for combination, the most important of which is the control of prices. Eliminate competition and with it go "price-cutting" and long time contracts. To the producers are secured more stable prices and an opportunity to adjust quotations to the state of trade. In times of good business and active demand they will not be compelled to bind themselves to a low price level by long contracts; and when business is dull, there will be no reckless cutting of prices by hard pressed firms, as is usual under competition, and which does the market untold harm. Moreover, the manufacturer will be able to charge what the traffic will bear. He will get from the consumer all he will pay, and in addition, will frequently be able to reserve for himself the share of profits which, under the old system, went to middlemen and secondary producers.

With the fear of his rivals withdrawn the manufacturer will be able to meet his customers on equal ground and to hold them to their contracts. Under competition merchants make a practice of finding fault, quibbling over trifles, and, not infrequently, of claiming a shortage in their shipments. Formerly the manufacturer would usually grant their claim, knowing that refusal to do so might, and often did, mean the loss of a purchaser. But once competition has been supplanted by combination, the buyer has no choice and the manufacturer is inclined to be much more firm, as he is in correcting the abuse of long delays in settling for orders.

The control of prices and the control of purchasers are great advantages gained by combination, but there is a third,—the control of labor. Under competition a single manufacturer meets a union of 20,000, 50,000 or perhaps even 100,000 men or more, controlled by a single executive board and supported by large funds gathered together in the course of several years. Such a union demands higher wages with a strike as the alternative. To grant the demand means that the manufacturer must submit to a reduction in his profits. Yet resistance places him at a serious disadvantage. He must sell his product to meet his obligations. He must fill his contracts to hold his customers. He cannot afford to close down his plant for any length of time.

The unions, of course do not make their demands on all the manufacturers at . . . They concentrate on a single one

until he yields, and then focus their strength on another. All the manufacturers may feel like refusing the demands, but the position of the union is so strong, in comparison with their own, that refusal would mean ruin. But under combination all is changed; unanimous refusal is possible.

Now, the manufacturer is not at the mercy of a strike and can measure his strength against the union. In the event of a strike he concentrates on the plants in which he has least to fear from the union. His important orders receive first attention. He asks his customers to be patient. He gathers in non-union men, and gradually increasing his working force, reopens one plant after another, until all are again producing. "Finally the reserve funds of the strikers would be exhausted, their courage weakened by such determined resistance, their confidence in their leaders impaired and the solid wall of their resistance honey-combed with disaffection, until first singly and then by hundreds, the strikers would be clamouring for re-instatement on the old terms and the union officials, compelled to surrender to save their organization, would concede their defeat and make an abject surrender." (Meade: Trust Finance, p. 73).

It should be borne in mind that we are here merely stating the attitude of the capitalistic class when so organized that they can meet the threat of a huge labor organization, on equal, or on more than equal, terms. We are not concerned with the ethics of the case, but merely with a statement of facts. Perhaps the point has been over-estimated; but at least it is plain that a combination great enough to practically dominate an industry is in a very strong position in dealing with the demands of labor.

Other Advantages of Combination.

These are the three great advantages; there are also minor ones of more or less importance. We might mention the improved position in dealing with railroads and producers of raw material. There is no more discrimination, no more different prices to different buyers, no more rebates and free storage on tracks. The small buyer no longer has to wait until his more important rivals have been supplied. Moreover, there is the advantage of large scale production—the economies of concentration of office staff, savings in cross-freights, reduction in number and salaries of selling agents, and in the cost of advertising. Patents and special processes are distributed, and the best available talent is employed to raise the standard of the poorer plants.

Optioning the Plants.

Having induced the individual competitive owners to enter the combination, the promoter now addresses himself to the more serious task of securing options on the various plants. His first step is to ascertain what each of the individual plants has earned for, say, the past three years.

In determining this many factors must be considered. The promoter cannot accept the bare statement of gross receipts and expenses. He must look to the reserve and depreciation accounts of the plants. One company may be playing a large dividend while "skinning" its plant and neglecting to keep up repairs. Another may charge the cost of machinery to capital account, while a third purchases its machinery with part of its net receipts. These considerations must be carefully estimated by the promoter. "He must reduce the earnings of all the plants to a common denominator of identical conditions." (Meade).

Knowing the earning power of the plants, the promoter is able to estimate their probable increased earning power under combination. Again several factors must be considered, some of which may be known, while others can only be estimated. As the more familiar economies of combination have already been mentioned they need not be repeated here. But by careful accounting, with the assistance of experts, the amount to be saved on the more important of these may be quite definitely ascertained.

But what is to be gained by the regulation of prices, by the possession of monopoly power, by the control of labour, the shortening of credit and so on, is purely an estimate. The promoter must determine, as best he can, how much will be gained by the shortening of contracts and the withdrawal of concessions. He must decide what can be gained by internal reorganization, by distribution of patent processes, by raising the standard of the less efficient mills. None of these things can be definitely determined—the promoter is reduced to "elastic approximations."

The promoter now approaches the owners with his proposal. He asks them to sell him the right to purchase their plants for a corporation which he proposes to organize, at an agreed upon price and for a definite time. He intends to fix the capitalization of the new company at an amount which will represent the supposed earnings of the combination, and to pay the owners of the competing plants in one of three ways. He will give them a cash payment down; or he will give them securities of the new company, or he will pay them partly in cash and partly in stock.

But no agreement can be closed between the promoter and the individual owners until they have arrived at the valuation to be placed upon the properties. It is unusual that the promoter will reach this stage without being more or less closely associated with some of the larger and more influential owners, with whom he is probably compelled to share his profits. These, and the strong firms who have been paying good dividends, despite competition, are absolutely essential to the promoter if he is to succeed. They must be brought into the combination at any price.

But when the promoter turns from these to the smaller and weaker owners his task is different, and from them he recovers the losses on the indispensable plants. For various reasons he often finds these manufacturers anxious to sell. Perhaps they have grown weary with the competitive struggle for existence; they may be advancing in years; their plants are often in disrepair and heavily mortgaged and under competition there is little prospect of disposing of the plant for anything like the money invested in it. As an isolated unit it is worth comparatively little—but its saleability is much increased by combining it with others. It is here that the promoter is working for his profit and sometimes he does not hesitate to threaten small firms with inevitable losses should they be left outside the combination. By one means or another, by alliance, persuasion or coercion, he secures options on an entire industry.

Very often the small, and often antiquated, plants are scrapped when once the combination is effected. The real reason for taking them into the new combination is not their actual worth as going concerns, but their potentialities as possible competitors if they are rehabilitated. From the point of view of society at large this scrapping of obsolete plants may mark a real advance; because inefficient and antiquated methods generally mean a high cost of production and hence high prices to the consumer. From the point of view of labor there is also a considerable gain if the merger results in giving steady employment at fair wages.

Paying the Owners.

The promoter now arranges for taking up these options. Must he pay cash for the properties, or will the owners be satisfied to accept securities of the new company? Promoters with abundant means at their disposal, or with adequate financial backing, are able to offer the owners cash down for their plants and so secure them at a lower figure than they would

be required to pay in either stock or bonds of the trust. But usually the promoter is unable to pay the owners any large proportion in cash. If he is to pay cash he must obtain it from the sale of the securities of the new company to middlemen or underwriters, who demand a bonus in the form of stock, and the more cash he requires, the larger is the bonus. Moreover, it is to the promoter's advantage to keep the original owners in the new corporation, for it shows that they have confidence in the future of the company to which they sell their plants, which is a valuable factor in selling the stock to the public.

An instance of this is given in the prospectus of the United Motion Picture Theatres, Limited, which offered its stock to the public in 1914. It assures the prospective investor that "the people selling their interests in the component Companies are taking payment therefor entirely in shares of this Company and are getting no cash out of the transaction. Not only is there no desire on their part to sell the shares thus acquired, but they are holding them for the purpose of adding to their interests by way of new securities obtained by this Company in new picture houses to be established by it." And the Toronto firm that sold the stock stated that "the owners of the stock in the six theatres mentioned in the prospectus received stock in the new or present company for their interests to the extent of \$330,000 in Preference stock and \$900,000 in Common stock, but not a dollar in cash, which," they add, "is pretty good evidence of faith in the proposition." (Statement of Pellatt and Pellatt Share Brokers and Financial Agents, Toronto).

Besides assisting in the appeal to the public the presence of the former owners in the new company secures to it their experience and advice. In some cases the promoter offers the owner a position in the new company in order to encourage to option his plant; but the co-operation of the owners is always sought and invariably proves a source of strength to the young corporation.

Fixing the Capitalization.

The promoter is now well along with his proposition. He has secured options on all the properties and has arranged with each owner how he is to be paid. He must now fix the capitalization of his Company. The plan usually followed is to issue sufficient preferred stock to buy the plants, and common stock to represent the additional value which these properties acquire under combination. An illustration will make this clear. The promoter may have found that the component plants are worth \$20,000,000. He therefore capitalizes the

company at, let us say, \$60,000,000, one-third of which is seven per cent. cumulative preferred stock and two-thirds common stock.

The former owners will not, as a rule, accept common stock for their plants except by way of a bonus; but they are willing to take preferred stock as it gives them a position of advantage with respect to voting power or dividends, or both. An excessive capitalization injures both the owners of the business and the general public; for the company, in the long run, must maintain a certain level of dividends on its stock, both common and preferred, in order to protect the credit and its borrowing power: while an excessive capitalization may mean high prices for the public, especially if the corporation seeks to pay a dividend on all its outstanding stock. The public, therefore, is directly and necessarily interested in the capitalization of corporations.

Bond issues. In recent years trusts have made a practice of issuing preferred stock as far as possible, in lieu of bonds, in the raising of capital. The reason for this policy is that bonds constitute a fixed charge on the income of the company; whereas, the dividend on stock may be passed in a lean year. An examination of the capitalization of ten trusts organized in Canada within the last few years shows that they issued \$41,270,800 in stocks and \$17,856,966 in bonds. Concerning this important question—the issuing of bonds or stock to secure working capital, we may quote the opinion of some leading authorities on the subject. Mr. W. H. Lough (*Corporation Finance*, p. 191) says:

“The bond issue probably cannot be sold on advantageous terms because the consolidation must necessarily be an experiment at the beginning and even its best securities will have a speculative character. Furthermore, in many cases the promoter will find the property of the subsidiary companies already mortgaged, so that the bonds of the consolidated company, whatever title he (the promoter) may pick out for them, will be in reality junior liens.” Mr. Jeremiah Jenks (*The Trust Problem*, p. 84) states that: “If a business is more or less speculative in its nature and is heavily indebted, there is always danger that in some period of depression it may fail to pay interest on its bonds and may thus have the management taken out of the hands of its directors. In consequence of this danger it has been customary of late years for those organizing the somewhat speculative industrial combinations to issue certain classes of preferred stock in lieu of bonds.” Mr. Meade (*Trust Finance*, p. 104) says: “The new corporation might give to each owner or stockholder its obligation to pay him twenty years from date the amount of money agreed

upon as the value of his property, and in the meantime to pay 5 per cent. interest on the bonds. Such a course, it would seem, would give the owners the security which they required. This plan, however, is open to serious objections, chief of which is the fact that the issuing of bonds materially lessens the value of the stocks out of which promoters and underwriters are to get their profits; and also because so large an issue of bonds as would be necessary to purchase all the plants at the agreed valuations, would endanger the solvency of the corporation on every fluctuation of profits. Bonds were little used in the flotation of trusts. The trusts which were organized from 1898-1900 issued \$3,343,065,000 of stock and \$440,945,000 of bonds."

The next step in the promotion of a new organization is the securing of working capital. This is done either through a banking house or a financial broker, or by the direct sale of securities to the public. In the former case the functions of the underwriter are called into play. Both these methods of financing the undertaking will be explained in detail, however, in the following Lesson.

The Promoter's Profits.

It is too often assumed that the promoter belongs to a class of individuals who make it their sole business to promote enterprises. In reality most Canadian money-making schemes are pushed by men who are promoters only for the time being and who have regular occupations and businesses which they leave while engaged in discovering, assembling and financing the new enterprise.

There are, however, some professional promoters; men who make their living searching for new schemes and enterprises. But these instances are rare. Such promoters are fervent individuals with a persuasive air, a vivid imagination and a faculty for appealing to the aspirations and emotions of others. Usually they are honest in their convictions for they can believe whatever they wish to believe. They are visionary and of unbounded enthusiasm. The professional promoter has to do with strictly doubtful and highly speculative enterprises. He is usually selling stock in Porcupine Mining companies, Alberta oil fields, Prince Edward Island fox companies, the Garden of Eden Real Estate company or Mexican rubber plantations. He belongs to the class that stop you on a street corner and attempt to sell you a lot at Athabasca Landing—on the corner opposite the new post office, at a ridiculously low figure, which he is willing to let you have on "easy payments" spread over several months. He possesses a wonderful ability

to talk, and manages to make enough on the scheme to meet his loss on another, and keep himself alive in the meantime.

Much superior to this group are the promoters who are primarily brokers, lawyers or bankers, but who have won a few great successes in the field of promotion. These men do not go about hoping to stumble upon opportunities, but the propositions which they undertake are often closely related to their own businesses, or are those which they have been called upon to undertake as the result of a successful promotion. They are men of sound business judgment, of persistent diligence and ability for organization. They are possessed of a rare and highly valuable combination of talents, are keen, shrewd, far-sighted, prudent, good bargainers, persuasive, and, above all, they are able to inspire confidence.

Lawyers and others in small communities, owing to their exceptional opportunities to inform themselves as to local conditions, frequently take hold of some local enterprise, and with the assistance of experts, carry it through to success. The tendency in this case is, however, to let one's enthusiasm blindfold his judgment, and enterprises taken up without mature consideration are later dropped on account of unforeseen difficulties.

The Promoter's Pay.

The most vital question that arises between the promoter and the corporation is: How shall the promoter be paid for his services? Usually the promoter feels that all he can get is none too much; but the shareholders always endeavor to keep his profits at a minimum.

Information in regard to the pay promoters have received in Canada is very difficult to secure. The prospectus of the International Black Fox Company admits that the promoter received 10 per cent. of the capital stock, but as a rule prospectuses make no mention of the amount paid the promoters, and an enquiry provokes only the indefinite reply that the promoters received a small stock commission for their work. The Report of the United States Industrial Commission, however, reveals some important facts (Volume II, p. VIII).

Promoters have been paid in various ways. In some cases they received 5 per cent. of the total stock issued, but had to meet all the charges of lawyers, accountants, appraisers and bankers. A more usual method is to give the promoters a certain amount of stock with which to buy the plants required and to pay expenses. Their profits depend in such cases upon their shrewdness and bargaining ability. In the case of the American Smelting and Refining Company the promoters received 30 per cent. of the common stock, out of which they had to pay the entire expenses of organization, and retained the remain-

der for their profits. Speaking generally the promoters receive a percentage of common stock as pay for their services and for covering the costs of organization, so that their profits will depend upon the care with which they can hold down their expense accounts, and in many cases, where the purchase of plants is entirely in their hands, upon the skill which they can show in making purchases.

Is the Promoter Over-Paid?

The successful promoter is undoubtedly highly paid, many having made millions and tens of millions in a short time. To the onlooker it seems impossible that these millions could have come honestly, that they are legitimate earnings. But let us see. If the promoter works thoroughly, he will spend weeks, perhaps months, in careful investigation of the enterprise and the possible causes of failure, before he seriously undertakes it. He will probably find that only a small percentage of all the enterprises he examines are sound. The time he spends on the others brings no returns.

In assembling the proposition the promoter takes considerable personal risk. The money he spends in securing options will be absolutely lost, unless his promotion proves successful, and he frequently incurs heavy personal liabilities. The promoter is a creator of value—he provides a means of producing wealth which did not exist before and his achievements are of great importance to business and industry. The constituent companies in an industry may be worth \$10,000,000. The promoter combines them and at once their value is doubled. A coal area owned by a score of farmers is not worth above \$20 an acre. The promoter organizes a company, supplies transportation facilities, and the value is \$100 an acre.

Besides, the promoter does a work no one else can do. Whether it is individual owners of a coal area or hostile competitors in the canning industry, they cannot agree among themselves to combine. There is too much jealousy, suspicion and bitter rivalry. Some outside third party, acting exclusively for his own advantage and dealing independently with each owner is essential to the assembling of such propositions.

The promoter's function is indispensable in the community. He acts as the middleman between the investor and the man with undeveloped property awaiting money. Left to themselves they might never meet—but the promoter brings them together and wealth is the result. No one should complain, then, if the promoter retains a large share of profits, for his services are of great value to the community and frequently have brought about improvements and the better organization of industry, which underlie our modern prosperity.

Questions for Review.

1. State briefly the opportunities in Canada for promoting new organizations. In what particular line is the promoter likely to meet with most success?

2. What type of business can be promoted best among one's friends? In what cases is it essential to appeal for financial help to banking houses or financial brokers?

3. What is meant by "assembling" the proposition? When is it necessary to call upon the advice of professional men and technical experts?

4. What are the functions of the "trust" promoter? What are the main difficulties he must overcome? What arguments will he rely upon in effecting the merger?

5. How are the owners of independent firms paid when they sell out their interests to the combine or trust?

6. Why does a new company prefer to raise capital by an issue of preferred stock rather than by the sale of bonds? To what extent is common stock given investors by way of a "bonus"?

7. How is the promoter paid for his services? Is the promoter as a rule over-paid?

8. Why is there a strong tendency toward consolidation among small as well as among large industrial establishments?

9. What is the usual basis of the consolidation of companies, and how is the exchange of stock determined?

10. Describe some prominent amalgamations of industries in Canada.

11. Why is it important for the promoter of a combination to consider with special care the means of providing his new corporation at the outset with sufficient cash?

12. "The trust carries with it the germ of its own destruction. The alleged advantages of large-scale production are fictitious and the savings of the wastes of competition are more than offset by the wastes of monopoly. Abolish special privileges and improper methods of competition and the trust will die of itself." Do you agree? Why, or why not? What do the promoters and leaders of industry appear to think on this question?

13. May any of the evils of "high finance" commonly attributed to the trusts be more properly regarded as characteristic of corporations as such? If so, which?

Questions for Written Answer.

14. In the United States, up to 1897, the number of trusts was comparatively small. Most of the existing trusts were

formed between 1898 and 1902, when there was a great deal of capital available for investment in industries, the great era in railroad building being over. In Canada the merger movement has been prominent in the last five years. How do you account for that fact?

15. Explain briefly the principal functions of the promoter.

16. Explain the steps by which a trust is organized.

17. Bring up any difficulties.

LESSON V.

Selling the Securities; the Functions of the Underwriter; the Prospectus.

The Sale of the Stock.

There are two ways of selling securities, direct to the public or through investment houses. If the issue is large and of not too risky a nature it is underwritten by a syndicate and sold through brokerage firms and banks. But in many cases, as with mining companies, small cities, etc., the issue is too small to make underwriting worth while, and even if it were large enough to interest underwriters, it would be too speculative and uncertain for them to have anything to do with it.

In such cases the corporation itself undertakes the sale. Frequently the services of a financial agent are sought and with his help a prospectus, circulars and draft letters are prepared. This advertising is turned over to an agency and a campaign is started through magazines and newspapers. Not unfrequently salesmen are sent into the outlying cities and towns, who advertise their presence by means of the local papers, and invite interested parties to call on them at their hotels. If it is an industrial or public utility concern a determined effort is made to dispose of the securities in the vicinity in which the plant is to locate.

The preparation and distribution of a circular or prospectus, or the publication of a general advertisement is but the first step. It brings enquiries which are followed up by extended and persistent correspondence, each letter ending with the assurance "that any further information you may require will be cheerfully furnished" or more urgently, that "we consider this offering extremely attractive and suggest your application by wire as we have every reason to believe that the security will be over-subscribed." Much patience, work and time are expended in selling stock by this method, which costs from \$5,000 to \$10,000 to raise \$100,000, and there is an ever-present uncertainty about the success of the issue, which hampers the directors in their work; for, if they have decided to build a plant costing \$1,000,000 and sell only \$800,000 worth of securities, they are in an unhappy position. They can neither complete their plant nor return the money. The corporation has no facilities whatever for selling its bonds and stocks; its activities are in the field of transportation or in-

dustry, or trade, not in finance, and if it must create a selling machine, it will be only temporary and at excessive cost.

Provided underwriters can be induced to accept the issue many difficulties will at once disappear. In the first place the corporation knows, from the moment the contract is made, exactly how much it is to receive for its stock and bonds; and it knows the exact date at which this money will be paid. Besides, the cost is actually less than selling through the haphazard hit-and-miss newspaper advertising, for the investment banker is an expert in selling securities and has an established clientele of investors to whom he may readily dispose of almost any securities which he recommends.

In the last analysis the stocks and bonds must be sold to the investor or the speculator. The securities that are placed through an underwriting syndicate appeal more particularly to the investing class. A heavy responsibility is thus placed on the financial house that manages the underwriting syndicate. To a certain degree the preferred stocks and bonds at least are regarded more highly by buyers because they are sold through reputable channels. The public, therefore, has a right to expect that only reliable and legitimate undertakings will be recommended by the members of an underwriting syndicate.

The underwriter guarantees the sale of the stock within a certain time, at a stipulated price, agreeing to take what is left at a certain stipulated price, usually several points below the anticipated market price, according to the nature of the security. An investment house is selected to manage the transaction. Through it the original contract between the underwriting syndicate and the corporation is made. The firm is known as the syndicate manager and assumes all responsibility, ensuring the sale of the securities and agreeing to purchase what it cannot immediately dispose of itself.

The syndicate manager prepares a document which is circulated among the financial houses which are to be permitted to assist in the underwriting. This document, called the syndicate agreement, sets forth that its subscribers agree to purchase after a given date, at a stipulated price, the amount of stocks and bonds opposite their names. Sometimes an opportunity to subscribe is given to favored customers and clients of the firm, but usually the underwriting is confined pretty much to security houses and banks.

The syndicate manager allots the securities to the various subscribers, not in proportion to their subscriptions, but as he deems best, always remembering that he is responsible for

the entire issue and that his own interests are paramount. The issue might be subscribed twice over, in which case each firm would not receive half its subscribed amount, except by accident, but some would be allotted their full subscription, while others would receive only one-quarter or even less.

The subscribers to the agreement may be called upon to pay a part, perhaps 25 per cent. of this subscription, at once; but the corporation or syndicate manager is readily able to raise a large part of the value of the entire issue on the security of the underwriting, and in the meantime the sale is opened to the public.

As a rule the subscriber to an underwriting agreement does not expect to remain, or even temporarily to become the owner of the number of shares for which he subscribes. He is permitted, if he wishes, to withdraw any of the securities at the price named and occasionally he becomes the permanent purchaser of a block of stock at the low price; but he expects that the stock will be sold before the date named in the agreement, and that, for a small expenditure, he will receive a profit equal to the difference between the underwriting and market prices, multiplied by the number of shares he has underwritten.

An example will make the transaction clear. Suppose that of an issue of \$1,000,000 an underwriter subscribes for 1,500 shares, par value \$100, at \$75. Ten per cent., or twenty-five per cent., or even one-third of this amount may be paid in, or no payment may be made at all. Suppose that the shares are sold to the public at \$90. The underwriter will receive a cheque from the syndicate manager for the amount which he has paid in, i.e., \$37,500 plus his profit of \$22,500. In case the public does not take the entire offering before the stipulated time the underwriter will be notified by the syndicate manager that he must take up the balance of his subscription, and he finds himself with 500 or 1000 shares for which he has paid \$37,500 or \$75,000, as the case may be.

The debenture stock of the Canada Steamship Lines, offered on February 18th, 1914, was underwritten at 87 and floated at 93. If the entire issue of \$9,000,000 had been sold, the underwriters' profits would have been \$540,000, but as a matter of fact, the issue got a cool reception in London and the English underwriters were called upon to take from 70 to 80 per cent. of their subscriptions. In such cases, of course, there is always the possibility of a market advance which will enable the underwriters eventually to dispose of their holdings at a profit.

As a rule no house guarantees the success of a large security issue even though it may be satisfied as to the worth of the enterprise. But as a banker never knows what is going to happen in the financial world, or when the bankruptcy of a big concern, or unexpected political events may create a sudden

panic, he considers it unwise for his house, or even two or three houses to underwrite a large issue. Many investment firms refuse absolutely to underwrite more than a certain definite sum, say \$100,000 to \$500,000, depending upon the size of the house, even when the risk is practically eliminated.

Moreover, each security firm has a long list of clients to whom it must offer a variety of stocks and bonds if it is to hold them as regular customers. This it could not do if it specialized too much, and was compelled to offer a limited choice because of underwriting excessively large issues.

To the corporation, the underwriting is of immense value in addition to the advantages already noted. This is instanced in the remark of Mr. James Carruthers, president of the Canada Steamship Lines, Limited, that "whether the issue has been fully subscribed or not, is of no real importance to the Canada Steamship Lines, as the full debenture issue was sold two months ago to a group of London and Canadian capitalists, who have already paid 50 per cent. of the subscription price and the balance has to be paid before May 1, next." (*Monetary Times*, Feb. 20th, 1914, p. 396).

The mere fact that responsible underwriters are willing to stand behind the new corporation and insure the sale of its securities, is strong endorsement of the success of the venture, and has much weight with the investing public and especially with the clientele of the financial houses involved in the transaction. Indeed if a corporation succeeds in having its securities underwritten by well-known and responsible concerns, a successful flotation is practically assured.

Underwriting the Trusts.

It might be argued that between the great industrial trust with a man of wide financial and business experience at its head, whose name is an assurance of the worth of the enterprise, and a scheme of a highly speculative nature like the Eureka Sunset Oil Co., Limited, of Winnipeg, there is nothing in common. Let us see. The promoters have organized the cement mills, or the asbestos mines, or the canning factories of the country into vast corporations, whose individual companies have already succeeded, and whose profits must now increase since competition is eliminated. It is claimed that the earnings of the constituent companies before consolidation were ample to pay interest on bonds and dividends on preferred stock, and that the common stock represents the capitalized value of the economies of combination.

It is this last feature that robs the enterprise of the pure investment element and throws it into the class with mining concerns, fox companies and town-site corporations. What is

the difference between the syndicate manager who claims that the common stock, which sells at 30 or 40, "is expected" to yield a dividend of 10 per cent., and the Cobalt speculator, who argues that the mine "ought" to be rich? The trust is more dignified, that is all. In neither case can the common stocks be sold to the investor, and the speculator takes them only on the prospect of a large rate of return.

Since the combination needs money for working capital, and in some instances to take up options, and since no investors are willing to come to its help, underwriting is necessary. With the large mergers the underwriters have been the best banking and investment houses in the country, giving the stock an undue prestige and market strength by their endorsement. Mergers in Canada as a rule have not been so excessively over-capitalized as in the United States, and so their securities have not been of so uncertain a nature. The recent steamship consolidation claims that the tangible assets of the individual companies amount to \$22,867,000, while the total capitalization of the new company is \$25,000,000. Similarly the Canada Cement Company, capitalized at \$30,000,000, claimed that the individual plants, with the additions made to them during the first six months immediately after organization, represented \$27,000,000. The Amalgamated Asbestos Corporation, organized in 1909, is a striking exception, but it was so overcapitalized that it lasted barely three years.

The testimony given before the United States Industrial Commission shows that the promoters and underwriters of some American mergers received large blocks of stock in the overcapitalized trusts of recent years. A couple of instances will illustrate. For each \$100,000 cash value that the Standard Distilling and Distributing Company received in the form of either cash or tangible property, there was issued to the promoter \$150,000 in common stock. In addition to this, \$100,000 in preferred stock and \$100,000 in common stock were issued to the seller of the property, and \$100,000 of preferred and \$150,000 of common stock were issued to the underwriters. Hence, every \$100,000 cash valued property was presumed to earn dividends on \$600,000 of stock.

The American Tin Plate Company, organized by Judge Wm. H. Moore, at the special instance of the competing owners, was capitalized at \$50,000,000 of which \$46,000,000 was later issued. The capital stock was to provide for the purchase of the properties and \$4,000,000 in cash for working capital. It was understood that options on the plants amounted to about \$18,000,000, with a 100 per cent. bonus of common stock, so that \$36,000,000 of stock was issued to owners. Ten million of common stock went to the promoter who had to meet all expenses of incorporation.

The Distilling Company of America furnishes a still more remarkable example. Of its \$55,000,000 preferred stock and its \$77,000,000 common stock, the promoter and underwriters received \$31,205,000 of preferred stock and \$46,250,000 of common stock. After purchasing the competing plants, \$10,710,000 of preferred and \$13,360,000 of common stock remained. For this they were to secure \$5,000,000 cash to provide working capital and purchase two distilleries. (Report of the United States Industrial Commission).

Usually an understanding is arrived at by which the owners of the individual companies are not permitted to throw their holdings in the new corporation upon the market until after a certain time, so that the promoters and underwriters may have a chance to dispose of their stock before the demand has been met and the price broken. Comparatively speaking the stocks of Canadian amalgamations have fluctuated little, but in the United States it is different. In the case of the Distilling Company just mentioned, the stock declined so rapidly that if the organizers had had the \$100,000,000 of preferred and the \$13,000,000 of common stock left on their hands six months after the issue was floated, they would have barely been able to raise \$3,500,000 for working purposes, alone.

Very often, especially in the United States—as is explained more fully in a later Lesson—the market is systematically prepared for the reception of the securities of the new organization. A frequent practice is the holding of "wash sales"—purely fictitious sales—to secure an artificially high price for the securities. It seems only fair, however, that bankers and brokers who sell such securities to clients should as far as possible prevent such practices, and give buyers complete information on the real worth of the stocks and bonds sold.

The Prospectus.

If the securities of the new company are to be sold to the public through bankers or established bond or brokerage houses the prospectus is a very simple document. The security company has a reputation gained through years of careful service, and the mere fact that it is offering the issue is sufficient inducement to investors, especially if the vendors recommend purchase. The investment house usually prepares a circular of two or four pages, containing only a formal statement of the facts, with sometimes a tabulation of the assets and earnings of the company, or figures of some other kind. Although such a presentation is unattractive when compared with the artistic and well-executed prospectuses of speculative enterprises, yet

it is effective, for it carries with it a sense of conservative safety, the only persuasion being the final statement—"We recommend these bonds as a thoroughly sound investment," or "We consider this is one of the strongest Canadian Industrial Bonds and unhesitatingly recommend same as a conservative investment."

But the majority of Canadian companies, either because of their speculative nature or limited capitalization, or for some other reason, do not sell their securities through investment houses, but make their appeal direct to the public through newspaper and magazine advertising, through circulars and follow-up letters, and through salesmen.

Not infrequently the secretary-treasurer of the new company undertakes the sale of the stock. More frequently he calls in the assistance of a financial agent who has had experience in following up advertisements; and in some cases such agents, with a dozen or so stenographers, undertake the entire sale for which they are paid, sometimes a cash commission, often a cash commission and a small common stock commission.

In reaching the investor through the mail or general advertising some literature is necessary, and since W. Bonham printed the first prospectus in London about 200 years ago, in which he attempted "a proof that the South Sea Company is able to make a dividend of 38 per cent. for twelve years, fitted to the meanest capacities," prospectuses of every description have been issued in all industries to prove the most impossible things.

The prospectus is often a work of art. The covers are artistically designed, the paper is of high quality with expensive cuts and frequently pleasing border designs on the pages, while the press work is performed with care and precision. A good prospectus appeals to a large number of people, holds their interest and inspires confidence. A poor one frequently means disaster to the flotation from the first.

A striking contrast is afforded by two fox company prospectuses issued in 1914. The former is an admirable effort of a dozen or fourteen pages, printed on attractive paper with photographs of foxes and ranches at the foot of each page. The reading matter is well prepared, the argument well written and finished. The cover is pure white but set off attractively by a raised design in black of two foxes, one sitting upright, the other reclining. The whole is bound by a white cord, tied outside, and the general effect is very pleasing. It creates a good impression and inspires confidence in the company.

(Continued in next Bulletin).